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ABSTRACT

One of the goals of state prepaid tuition and college savings programs is that parents will soon consider participating in Section 529 plans for future higher education costs as commonly as they enroll in 401K plans for their retirement. Too many families are taking on far too much debt for college expenses, and tuition has been consistently rising at double the rate of inflation. The size of student loans is increasing, and more students are taking out loans. The ability of a state to increase the number of families who are prepared to meet higher education costs should eventually relieve pressure on that state's need-based financial aid requirements. As of October 17, 2000, 65 total programs were either operational or scheduled to launch. Establishing these programs and achieving broad-based acceptance is not easy, but such programs should continue to grow as families accept the responsibility of paying what they can afford toward their children's college educations. (SLD)

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Goals and Implementation Issues for State Prepaid Tuition and College Savings Programs

Joan Marshall

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GOALS AND IMPLEMENTATION ISSUES FOR STATE PREPAID TUITION AND COLLEGE SAVINGS PROGRAMS

Joan Marshall, Maryland Prepaid College Trust*

State Prepaid and College Savings Programs are growing exponentially across the country because they are providing real value, convenience, and "peace of mind" to families who are trying harder to prepare themselves financially for their children's and grandchildren's college education. While growth in participation in these plans is substantial, much more consumer awareness and accurate understanding of them is needed.

THE GOAL

One of our hopes at the state level is that parents will soon consider participating in Section 529 plans for future higher education costs as commonly as they enroll in 401K plans for their retirement savings. Why do we seek this goal?

1. *Too many families are taking on far too much debt*–often as much as tens of thousands of dollars–to send their children to college. There is clear evidence that families of today's college students have generally not saved nearly enough to cover the costs. This trend does not seem to be improving. Consider the following two factors:

- *Tuition has been consistently rising at double the rate of inflation.* The College Board reported recently that tuition and fees are up an average of 4.4 percent at public four-year colleges and 5.2 percent at private four-year colleges, while the consumer price index rose 2.7 percent in 1999.[1] To no one's surprise, loans are providing an ever-increasing amount of the extra money students need to pay these costs.
- *More students are taking out loans to finance increasing college costs and the size of those loans is increasing.* From 1980 to 1995, the U.S. Department of Education's loan portfolio increased from $2.2 billion to $11.5 billion.[2] A decade or more ago, about 60 percent of federal financial aid (the largest source of student aid) was in the form of grants, with about 40 percent in the form of loans. This situation has now reversed, so that in the last academic year, loans made up 59 percent of a record $68 billion in financial aid (Levinson, 2000).

2. Most families today (73 percent) say they are saving for their children's education and most consider it to be as important as saving for retirement. However, a survey completed in 1999 by the College Savings Plan Network (CSPN), an affiliate of the National Association of State Treasurers (underwritten by TIAA-CREF and BankOne), indicates that these families typically are not saving enough or on a regular basis. Even worse, the most commonly used savings vehicle indicated in the survey is passbook savings accounts (47 percent), which simply do not keep pace with tuition inflation (College Savings Plan Network, 1999).

WHY DO THE STATES CARE?

To the extent that families are better prepared financially to meet higher education costs, overall accessibility of higher education opportunities will be expanded. Too often, one of the main reasons why students elect not to attend college is because sufficient funds are not available. Clearly, increasing the accessibility of higher education will lead to a better educated workforce, which should, in turn, strengthen the states' economies and contribute to state economic development efforts to attract employers, particularly those in high tech, higher paying industries.

The ability of a state to increase significantly the number of families who are better prepared to meet higher education costs should eventually relieve pressure on that state's need-based financial aid requirements. While federal aid is the largest source of financial aid, it is worth noting the Chronicle of Higher Education's report that in 1995-1996 nearly 20 percent of full-time, full-year college students were receiving state financial aid.

*Joan Marshall is executive director of the Maryland Prepaid College Trust.

How are We Doing?

According to the College Savings Plan Network (October 17, 2000) 65 total programs are either operational or scheduled to launch:

19 states have an operational prepaid tuition program.

3 states are scheduled to launch a prepaid tuition program.

28 states currently have an operational college savings program.

15 states are scheduled to launch a college savings program.

48 states have at least one prepaid tuition or college savings program.

5 states have both a prepaid tuition program and a college savings program.

As of Summer 2000, there were approximately 1.4 million accounts with a total market value of approximately $7.6 billion. Florida comprises about 40 percent of the total accounts. Eight states (New York, Ohio, Texas, Alabama, Michigan, New Hampshire, Pennsylvania, and Virginia) comprise another 34 percent, and the remaining states make up 26 percent, many of which are growing very rapidly, but are too new to overtake plans in existence for 5-10 years (CSPN, August 2000).

A very important point is that the most successful states, like Florida, are beginning to change the culture, so that families who have college dreams for their children readily consider saving in advance with the prepaid college program. Florida's program currently enrolls approximately one out of six children in the state. The state is setting an outstanding example for many of the rest of us, like Maryland, with younger and much smaller programs.

Whom Do These Programs Serve?

The public policy goal of these programs has clearly been to appeal to families with middle incomes and higher who have at least some financial ability to save. Prepaid tuition programs typically offer units of tuition or the ability to purchase only one year of tuition in advance in order to attract those who do not have the financial resources to pay for all four years of college. Similarly, college savings programs typically offer low minimum monthly deposits–as low as $15 per month.

The Internal Revenue Code also provides very attractive estate planning benefits that grandparents should consider, with payments to Section 529 programs considered a completed gift for gift tax purposes. The Code also provides five-year averaging for individuals who contribute more than $10,000 ($20,000 for married couples) in a given taxable year. Therefore, total gifts of $50,000 per individual ($100,000 for married couples) are allowed in one tax year without federal gift tax consequences.

IMPLEMENTATION ISSUES

As the director of a state program, I can attest that establishing these programs and achieving broad-based acceptance is no easy task, even with their clear financial and tax benefits. First, the features need to be clear and easy to understand for middle income families. Again, this is no small task given the complexities of the federal and state legislative and regulatory environments. Second, the value of these programs vs. other investment options must be clear. While states have made great progress in gaining broader acceptance of these programs, there are several significant barriers to be overcome.

Consumer Awareness and Understanding

States typically have limited marketing budgets. Even with this limitation, however, advertising has helped improve awareness levels significantly. In fact, CSPN found that more than half (54 percent) of those responding to the 1999 survey were aware of state college savings programs, and of those, three quarters (74 percent) had favorable impressions of the plans. I believe that, although awareness has improved, most families do not yet have even a fairly basic understanding of how the programs work. In Maryland, for example, most families still are not aware that the program can be used toward tuition at private and out-of-state colleges. They typically think that because the Maryland Prepaid College Trust is a state program, it supports only the state's public colleges. While Maryland has a great public college system, it is just too limiting to think of where today's infant will go to college to make that a reasonable limitation of the program.

Public/private partnerships are beginning to play a significant role in helping improve the level of consumer awareness. Kroger food stores, for ex-

ample, is partnering with Pepsi and the College Savings Plan Network to hold a contest in their stores and affiliates across the country. Fourteen lucky grand prize winners will win $10,000 each to be invested in the state prepaid tuition or college savings plan of their choice (CSPN, 2000). In addition to obviously benefiting the winners, the advertising associated with this contest alone is of tremendous value in improving consumer awareness of these programs.

Final Section 529 Regulations

The industry is hopeful that IRS will issue final Section 529 regulations in the near future. As an industry association, CSPN has taken the position that there are several troublesome aspects of the proposed regulations in use by the states. Through CSPN testimony, meetings, and letters, we have communicated these concerns to IRS, and we hope that they will be addressed in the final regulations. A few of the most significant concerns include:

- *Transfers from one program to another should be allowed for the same beneficiary.* Currently, transfers must involve a change of beneficiaries. CSPN has suggested a cap of two transfers per year or eight over a lifetime.
- *The dollar limit of $2,500 per year for the use of "qualified education expenses" for off-campus room and board is far too low.* Average room and board costs for the 1999-2000 school year average $4,730 for public colleges and $5,959 for private colleges (as reported by the Chronicle of Higher Education). This change may require federal legislation.

Other Federal Legislative Initiatives

Several other industry improvements require action by Congress:

Adding "cousin" to the list of eligible relatives to whom benefits may be transferred;

Allowing earnings to be completely tax exempt at the federal level, instead of being taxed at the beneficiary's tax rate.

Correcting the disparity in financial aid treatment, whereby 100 percent of benefits from prepaid tuition programs may be added to a family's expected contribution, but college savings plan balances count as a parental asset, of which a maximum of 5.64 percent annually can contribute toward the calculation of the expected family contribution.

THE FUTURE

I believe that the future is extremely bright for state college savings programs and that they will continue to grow rapidly as families accept the responsibility of paying what they can afford toward their children's college education. Part of this growth will be driven by an increase in consumers' understanding of the advantages of saving in advance versus borrowing in the future. I believe that grandparents also will increasingly take advantage of the estate tax benefits of these programs. Congress, IRS, and the states will continue to fine-tune these programs to enhance their attractiveness. Several other factors will also contribute to the growth of these programs:

More public-private partnerships, building on the success of the Kroger/Pepsi initiative.

Increasing use of these programs for scholarships. Florida is leading the way by providing scholarships to disadvantaged youth. By purchasing prepaid tuition contracts for elementary and middle school students, drop out rates have been reduced substantially. Students who receive these "early scholarships" prepare themselves for college, since they know from an early age that the financial resources are there to support them.[3]

More corporate/employer involvement and assistance. These programs are ideal recruitment and retention tools for employers in a highly competitive labor market. And what about a 529 match as an employee benefit?

Notes

[1] Arlene Levinson, "College Board Survey Finds College Costs Still Rising Faster than Inflation," Associated Press, October 17, 2000.

[2] South Carolina Tuition Prepayment Program, 2000 Enrollment Booklet.

[3] Florida Prepaid College Foundation, 1999-2000 Annual Report.

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